California Student Aid Commission

Annual Report to the Legislature on EDFUND

Federal Fiscal Year
October 1, 2006 – September 30, 2007

Report Date: April 1, 2008

CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR

CALIFORNIA STUDENT AID COMMISSION 1955—2005 50 YEARS SERVING STUDENTS

April 1, 2008

Dear Members of the Legislature:

I am submitting "The California Student Aid Commission's 2006 - 2007 Annual Report on EDFUND" in accordance with California Education Code § 69529.5 (a), which requires that the Commission submit a report to the Legislature annually on the operation of its auxiliary organization, EDFUND.

The California Student Aid Commission (Commission) has been serving students and families for more than fifty years by providing financial aid services to support California's students in reaching their educational goals. The Commission is the primary agency responsible for the administration of state-aid programs, key among them the Cal Grant Program. The Commission is also the designated State guaranty agency responsible for the Federal Family Education Loan (FFEL) Program which it administers through its auxiliary organization, EDFUND. The Commission maintains responsibility for financial aid program administration, policy leadership, program evaluation and information development and coordination.

EDFUND was created in 1997, to provide operational and administrative services for the Commission's participation in the FFEL Program in support of the Commission's mission. Specifically, EDFUND is responsible for ensuring that federally insured loans are issued to students attending eligible post-secondary educational institutions and that loans are taken out through an approved FFEL Program lender; maintenance of borrower account information; securing borrower repayments on delinquent and defaulted loans; and payment of claims to lenders when a borrower defaults.

The enclosed report includes a description of the services provided by EDFUND, changes in the delivery of loans and program enhancements, the loan program annual budget, and the level of compensation of EDFUND managers and executives. While Federal changes brought new challenges in 2006-07 EDFUND accomplished:

- Processing more than $9.3 billion in student loans and managing a portfolio of outstanding loans currently valued at $30 billion.
- Producing overall operating revenues exceeding expenses of approximately $16 million in the Student Loan Operating Fund (SLOF).

State legislative changes will affect Commission and EDFUND operations and programs.

- Chapter 182, Statutes of 2007 (Senate Bill 89) authorizes the Department of Finance to sell the State's student loan program assets.
- The sale of EDFUND will affect the Commission's other financial aid programs and ultimately students and schools because EDFUND has provided administrative and financial support to the Commission in many areas.
- Due to the anticipated sale of EDFUND, the Commission's civil service positions associated with the administration and oversight of the FFEL Program will be eliminated. This will require the civil service staff assigned to EDFUND to be reassigned to the Commission, which will likely result in Commission staff layoffs.

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The proposed sale of EDFUND results in the Commission's reliance on the General Fund, therefore making the Commission more vulnerable and less flexible to proposed budget reductions. From 2003-04 to 2007-08, the Commission's operations and Cal-SOAP were funded by the SLOF. To preserve the assets in the student loan program for the sale of EDFUND, the Commission's administrative budget and funding for Cal-SOAP was shifted from the SLOF back to the General Fund in State Fiscal Year 2007-08. After 2007-08 SLOF will no longer fund outreach activities, such as the Cash for College Program. The Governor's 2008-09 Budget proposed in January includes the:

- Elimination of the Cal Grant Competitive Program.
- Reduction of the Cal-SOAP program by 10 percent.
- Reduction of the Commission's administrative budget by 10 percent.

The Commission management is facing these challenges with the intent of ensuring that, to the greatest extent possible, the awards and payments to students and institutions are not delayed.

This report as well as other reports produced by the Commission can be viewed on the Commission's website at www.csac.ca.gov. If you have any questions or need additional information, please contact my office at (916) 526-8271 or Ann Shimasaki, Legislative Liaison at (916) 526-8038.

Sincerely,

Diana Fuentes-Michel

Diana Fuentes-Michel
Executive Director
California Student Aid Commission

Mission

Making education beyond high school financially accessible to all Californians.

www.csac.ca.gov

Mission

EDFUND is dedicated to maximizing benefits to borrowers by being the premier service provider in the student loan industry.

www.edfund.org

EDFUND is an auxiliary agent of the Commission and therefore, the Commission is required to provide an annual report to the Legislature on EDFUND, which complies with Section 69529.5 of Article 2.5, Chapter 2, Part 42 of the California Education Code which requires:

§69529.5 (a) The commission shall report the following information to the Legislature on April 1 of each year, with respect to the operation of the auxiliary organization:

(1) A description of the services provided by the auxiliary organization.
(2) The auxiliary organization's annual budget, funded activities, and personnel, including the sources of revenue available to fund its operations.
(3) Descriptions of changes made in the delivery of loans to California students and enhancements to programs and activities administered by the commission. The descriptions shall reflect all changes, both positive and negative.
(4) The level of compensation of managers and executives of the auxiliary organization.

(b) Commencing on April 1, 2005 and on April 1 of each year, ending on April 1, 2010, the commission shall specifically describe the actions taken, and report the costs incurred and the revenues realized, by the auxiliary organization in disbursement services, loan servicing and repayment, secondary markets and private lender activities that the auxiliary organization undertakes pursuant to subdivision (a) of Section 69522.

Section 69529.5 of Article 2.5, Chapter 2, Part 42 of the California Education Code, as amended, pertaining to the creation of an auxiliary organization of the California Student Aid Commission.

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EXECUTIVE SUMMARY

In 1997, legislation granted the California Student Aid Commission (Commission) the authority to create a nonprofit auxiliary, EDFUND for the purpose of providing services related to the Commission's participation in the Federal Family Education Loan (FFEL) Program under the terms of an annual Operating Agreement. EDFUND manages the day to day administrative functions for the FFEL Program. The Commission is responsible for financial aid policy leadership and oversight of EDFUND and the FFEL Program.

In 2006-07, the Commission approved Governance Policies which set forth how the Commission governs and oversees its programs and the roles and responsibilities of the Commission and program staff as well as the EDFUND Board and president. A new Operating Agreement between the Commission and EDFUND became effective July 1, 2007. The Operating Agreement defines the terms and conditions for the administration of the FFEL Program and other services. As required in the Operating Agreement, the Commission also developed an Annual Plan for Oversight of EDFUND.

In September 2007, the Governor and Legislature agreed to legislation (Chapter 182, Statutes of 2007 [Senate Bill 89]) that authorized the Department of Finance to sell EDFUND or identify an alternative financial arrangement for the administration of the FFEL Program. In proposing the sale of EDFUND, Governor Schwarzenegger stated that the student loan guarantee business is not a core mission or competency of State government. Senate Bill 89 provides the Administration the authority to conduct this process. The legislation expires January 10, 2009. At the time of this report, a sale advisor had been contracted and the identification of a prospective buyer is not known.

To preserve the assets in the student loan program, the Commission's administrative budget and funding for Cal-SOAP was shifted from the Student Loan Operating Fund (SLOF) back to the State General Fund in State Fiscal Year 2007-08. In anticipation of the sale of EDFUND, the Governor's Proposed 2008-09 Budget includes additional resources in the Commission's budget for prospective activities necessary to reestablish essential core business and technology services that EDFUND has been providing to the Commission; but at the same time proposes the elimination of the Cal Grant Competitive Program, reduces the Cal-SOAP program, and imposes a 10 percent budget reduction to the Commission's administrative budget. The Commission will have to manage the transition of services along with the reassignment of civil service employees currently assigned to EDFUND while also coping with a significant budget reduction. The Commission has a very daunting task of ensuring that the awards and payments to students are not delayed due to the sale of EDFUND and implementation of budget reductions.

Results in Brief

Through EDFUND, the Commission has provided enhanced services and options to students in California and across the United States. As required by statute, this report provides information on the background of the Commission and the creation of EDFUND, as well as information on the services provided by EDFUND nationally, changes in the delivery of loans, program enhancements, the operational budget, and the level of compensation for managers and executives of EDFUND.

Services Provided

EdFund provides the following guaranty agency services consisting of: guarantee services, default aversion assistance, payment of insurance claims, collections, loan portfolio management, and program oversight. Service functions which are central to EdFund's competitiveness and success include: personal customer service; loan management solutions for schools and lenders; information technology support; and outreach and communications.

Prior to 1999, the Commission's loan program activities were limited to the in-state or California market. Legislation enacted in 1999 authorized the Commission to expand its loan operations out of state. In 2006-07, 55 percent of the Commission's loan guarantee volume was for borrowers attending out-of-state institutions. In 2006-07, the Commission was one of the nation's leading providers of student loan guarantee services under the Federal Family Education Loan Program and by the end of 2006-07 was maintaining a $30 billion loan portfolio. New loan guarantee volume in 2006-07, including consolidations, equaled $9.3 billion, a decrease of 7.7 percent from the prior year. This decrease was driven by a shift of two lenders to other guarantors at one of the Commission/EdFund's largest school customers.

In 2006-07, 77.4 percent of loan guarantee volume, excluding consolidations, was for borrowers at for-profit and proprietary institutions, resulting in a higher than industry average loan default rate and associated claims payments. During 2006-07, the Commission/EdFund paid $703 million in claims on defaulted loans guaranteed by the Commission, an increase of $184 million or 35.5 percent over the $519 million in claims paid in 2005-06, reflecting both the overall growth of the loan portfolio as well as its composition. The Commission's cohort default rate for 2005 was 8.6 percent which is a slight increase from 2004 rate of 8.2 percent.

Changes in Loan Delivery

The Higher Education Reconciliation Act of 2005 significantly affected guaranty agencies, lenders and borrowers. Guaranty agencies were required to deposit a 1 percent Federal Default Fee into their Federal Fund beginning July 1, 2006 and meet specific changes in collection efforts. The Commission paid the Federal Default Fee (by making the required deposit from its Student Loan Operating Fund) through September 30, 2006. Many lenders agreed to cover the fee through June 2007. Beginning July 1, 2007, EdFund implemented a strategy for fee sharing with lenders.

New federal legislation also required changes in loan collections. As a result, in 2006 EdFund changed its loan collection strategy from borrowers consolidating their defaulted loan under the Direct Loan Program to borrowers making payments on their loans and rehabilitating the loans to a non-default status. This strategy has been aggressive and successful for both the borrower and loan program revenue.

EdFund program enhancements include: improvements in technology to better serve borrowers, schools and lenders; increased training for default prevention; and changes in both published and online materials to assist students.

Annual Budget

In Federal Fiscal Year (FFY) 2006-07, revenues collected by EDFUND totaled $153 million against total expenses of almost $137 million, with $90 million of these expenses from standard loan program activity. The remaining expenses were predominantly related to the federal default fee subsidy of nearly $22 million and the Commission's administration of non-loan program activities, including outreach, of nearly $23 million. These expenses resulted in an operating surplus of approximately $16 million.

Level of Compensations for Managers and Executives

Executive management salaries are set by the EDFUND Board of Directors based on market surveys and individual qualifications; all other salaries are set by the EDFUND Human Resources Division based on market surveys and in consultation with hiring managers. EDFUND's executive management may receive incentive compensation as set forth in the Operating Agreement pursuant to the Commission's "Policy Statement and Guidelines Memo for EDFUND Incentive Compensation Plans". The Chair of the Commission reviews the incentive compensation amounts based on performance reports provided by the EDFUND Board and the Executive Director. The Commission Chair may either approve or decrease the incentive compensation amounts recommended by the EDFUND Board. For FFY 2006-07, incentive compensation was also approved by the Department of Finance as required in Chapter 182, Statutes of 2007 (Senate Bill 89). EDFUND executive management received approximately $1.9 million in total compensation for 2006-07.

BACKGROUND

The Commission is the State's principal provider of intersegmental statewide grant aid to postsecondary students. Founded in 1955 as the California State Scholarship Commission, the 15-member Commission's primary programmatic responsibilities include operation of the State-funded Cal Grant Program. The Commission will distribute approximately $900 million to California's college students during the 2008-09 academic year through its Cal Grant, targeted grant, scholarships and loan forgiveness programs. The Commission also administers financial aid awareness and outreach programs, such as Cal-SOAP and Cash for College, in collaboration with business, private industry and community-based organizations. The Commission administers the FFEL Program through its nonprofit auxiliary, EDFUND.

Federal Stafford loans are the largest source of federal student aid for eligible undergraduate, graduate, and professional students. There are two types of Stafford loans: subsidized, for which the government pays the interest while students are in school and during grace and deferment periods; and unsubsidized, for which students pay all the interest on the loans. Students may receive both types of loans at the same time.

Under the FFEL Program, qualified students can receive Stafford and/or Graduate/Professional PLUS loans, and their parents can receive PLUS loans (loans for parents) for the college costs of their dependent student. The FFEL Program also provides Consolidation loans which allow students to combine existing loans to make repayment more manageable. These loans are backed by the federal government and guaranteed by guaranty agencies, like the Commission.

There are currently 35 FFEL Program guaranty agencies in the United States. The Commission, through EDFUND, is one of the nation's leading providers of student loan guarantee services under the Federal Family Education Loan Program. EDFUND offers students a wide range of financial aid and debt management information, while supporting schools with advanced loan processing solutions and default prevention techniques. EDFUND is headquartered in Rancho Cordova, California with regional offices located throughout the nation.

Development of the EDFUND Model

Since 1978, the Commission has worked with three different loan program administration models. From 1978 to 1993, the Commission's loan program activities were outsourced to an external contractor. In 1985, following a comprehensive review of both grant and loan program operations, the Commission decided that it could operate the guaranty program most effectively by removing outside contractors and managing both operations and technology directly within the State system.

This decision was a result of an assessment that external contracting did not always guarantee superior service and its administrative costs were higher than desired by the Commission. Additionally, the Commission wanted to expand services to schools, make system operations more efficient, and save costs by merging the grant and loan administrative systems onto the same technology platform.

Following years of planning and system programming, the grant system became operational in 1991 and the loan system became operational in early 1993. From 1993 to 1996, the Commission administered all of the primary student loan program activities, except for mainframe support of the central database that was provided by the State's data center. The Commission continued to outsource some data programming through Electronic Data Systems (EDS), and also contracted with external collection agencies.

Since 1997, the Commission has administered the loan program through EDFUND. The Commission originally pursued the creation of EDFUND as a result of competitive pressures that threatened to force the Commission out of the FFEL Program. Prior to the creation of EDFUND, the Commission found the administration of the loan program difficult under State-agency constraints specifically due to inflexible data processing and technology system limitations and unresolved federal and state regulatory compliance issues. During this time, relations between guarantors and the U.S. Department of Education (ED) were tense because of ED's desire to implement the William D. Ford Federal Direct Loan (Direct Loan) Program.

Competitors who sensed that the Commission was in a vulnerable position because of its technology and service deficiencies entered the California market aggressively beginning in 1993. At the same time, about 30 percent of schools, including some of the largest public universities, changed to the new federal Direct Loan Program, which began its operations nationwide in 1994-95. In California, the share of Commission-guaranteed loans dropped from nearly 90 percent prior to 1993 to close to 50 percent by 1995.

The Commission and EDFUND have Saved California Money

Loan program revenue has been appropriated during State Fiscal Years 2003-04 through 2006-07 to fund the Commission's administration and program budgets as noted below. Use of the loan program revenue represented State General Fund savings.

- $11 - $15 million annually for the Commission's administrative budget;
- $8.5 million annually for the California Student Opportunity and Access Program (Cal-SOAP);
- $197.5 million total for the grant awards provided by the Cal Grant Program in 2004-05 and 2005-06.

The Commission has also approved the use of loan program funding for its annual Cal Grant Public Awareness Campaign and Cash for College Program to build student awareness of the opportunities afforded to them through the Cal Grant program and various other State and federal financial aid programs.

EDFUND has also provided administrative services to the Commission such as mailings, printing, and technology support, which saves the Commission staff time and money. The following are examples of some of the successful synergy projects between the Commission and EDFUND that occurred during the past year:

- <u>Student Expenses and Resources (SEARS) Survey:</u> the Commission gathers cost of education data on a three-year cycle based on the SEARS survey of California schools/students. Working closely with Commission staff, EDFUND developed an online survey system that provides the ability to customize surveys and to reuse the final product during the next survey cycle. The survey system maintains the survey, questions, answers, and results for each of seven different surveys based on school segments. The new system sends out e-mail invitations, tracks individual user progress, and sends reminder e-mails. The information is stored in a database and extracts are provided to the Commission as requested. The project was implemented on January 24, 2007.

- The Commission Grade Point Average (GPA) Imaging Optimization**:** This project extended EDFUND's record-imaging system to Commission GPA processing and became operational on December 14, 2006.

- The Commission Call Center IVR: An interactive voice response (IVR) system was established to help the Commission better manage inbound calls from students seeking assistance, especially during peak season. The IVR system became operational on November 21, 2006.

- FAFSA for Student/Parents Video and Fund Your Future Publications: The Commission and EDFUND continued their collaboration in these jointly developed products that are used by students, parents and schools to help students fill out the FAFSA and provide information on State and federal financial aid programs.

Sale of EDFUND

In May of 2007, the Governor proposed the sale of the student loan program assets, commonly referred to as the "Sale of EDFUND", indicating that the student loan guarantee business is not a core mission or competency of State government. Chapter 182, Statutes of 2007 (Senate Bill 89) established the parameters for this sale and authorized the Director of the Department of Finance (DOF) to act as an agent for the sale or alternative financial arrangement.

The bill prohibits the Commission from authorizing or approving any operating agreement with EDFUND to perform any new or additional services, except those services authorized by DOF as necessary or convenient for either the operation of EDFUND or to accomplish the goal of maximizing the value of the State student loan guarantee program assets and liabilities. The bill requires the Commission and EDFUND to obtain approval from DOF of all actions, approvals, and directions of the Commission until the consummation of the sale or the alternative transaction.

DOF has contracted with Bear Stearns as a policy advisor to maximize the State's profit on the sale of EDFUND. The original estimate of generating approximately $1 billion was recently reduced to $500 million as a result of recent federal changes that made the student loan guarantee program less financially attractive.

The bill requires DOF to notify the Chairpersons of the Joint Legislative Budget Committee and the Senate and Assembly Budget Committees of DOF's determination to proceed with a transaction other than a sale within 30 days prior to the consummation of the transaction or a later date that DOF determines to be most beneficial to the transaction. Upon the consummation of the sale or other transaction, DOF shall notify the Secretary of State and the Chairperson of the Joint Legislative Budget Committee.

In addition, the bill requires DOF to deposit all proceeds on any sale or any funds achieved through any other arrangement into the General Fund. If neither a sale nor any other transaction is anticipated, DOF must stop all activities authorized upon the earlier of either 30 days following written notice to the Joint Legislative Budget Committee that no sale or transaction will be pursued, or January 10, 2009.

The Governor also signed Chapter 184, Statutes 2007 (Senate Bill 91) on August 24, 2007. Senate Bill 91 would repeal provisions to existing law relating to the establishment and operation of EDFUND and the State's participation in the FFEL Program

To preserve the assets in the student loan program, the Commission's administrative budget and funding for Cal-SOAP was shifted from the SLOF back to the State General Fund in State Fiscal Year 2007-08. In anticipation of the sale of EDFUND, the Governor's Proposed 2008-09 Budget includes additional resources in the Commission's budget for prospective activities necessary to reestablish essential core business and technology services that EDFUND has been providing to the Commission; but at the same time proposes the elimination of the Cal Grant Competitive Program, reduces the Cal-SOAP program by $637,000, and imposes a 10 percent budget reduction to the Commission's administrative budget.

The Commission will have to manage the transition of services along with the reassignment of civil service employees currently assigned to EDFUND while also coping with a significant budget reduction in 2008-09. The transitioning of employees with loan program experience to the Commission's grant programs and the potential loss of the experienced employees currently administering the grant programs could have serious implications in the Commission's ability to provide services to students and schools. The Commission has a very daunting task of ensuring that awards and payments to students and schools are not delayed due to the sale of EDFUND and implementation of budget reductions.

SERVICES PROVIDED BY EDFUND

EDFUND provides the following guaranty agency services in keeping with competitive business services:

- Guarantee services: As a designated guaranty agency under the FFEL Program, the Commission (through its auxiliary EDFUND) will pay participating student loan lenders 97 percent of the outstanding loan amount if a student defaults on a loan. Default occurs after the borrower fails to make payments for at least 270 days, a period during which the borrower is typically contacted multiple times by the lender and guaranty agency and offered a variety of options for returning his or her loan to good standing.

- Default aversion assistance: Lenders must request default aversion assistance from the guaranty agency or guarantee services provider when a loan is between 60 and 120 days past the payment due date. As a part of this process, EDFUND engages in an active default aversion program designed to assist the borrower in achieving a successful repayment experience. This is accomplished by increasing borrower awareness of the variety of repayment options available, as well as the potential consequences of defaulting on a student loan.

- Payment of insurance claims: After a loan reaches a default status, the lender submits a claim to the guaranty agency. The guaranty agency then purchases the defaulted loan from the lender at rates determined by federal statute. The guaranty agency is in turn reimbursed by the federal government a percentage of the payment made by the guaranty agency to the lender. For all loans guaranteed after October 1, 1998 which later default, the guaranty agencies receive 95 percent reimbursement from ED.

- Collections: When a guaranty agency pays an insurance claim to the lender, it then attempts to collect reimbursement from the borrower. Funds a guaranty agency recovers from defaulted borrowers through the collections process are returned to the federal government, minus a percentage retained by the guaranty agency. In the event the guaranty agency exhausts all opportunities to collect on a loan, the loan may ultimately be transferred back to the federal government through a process known as mandatory assignment. EDFUND continues to focus on establishing debt recovery strategies that successfully balance the need to maximize recovery of taxpayer funds with its desire to match each borrower with the most appropriate repayment program.

- Loan Portfolio Management: EDFUND administered an existing loan guarantee portfolio valued at approximately $30 billion at the end of 2006-07. EDFUND tracks each loan's status on a routine basis and submits periodic reports to ED. EDFUND also consolidates status updates from FFEL Program lenders and reports them to the federal government through the National Student Loan Data System.

- Program Oversight: EDFUND's Program Review and Compliance Unit is responsible for reviewing its school and lender partners' compliance with federal regulations governing participation in the FFEL Program. EDFUND staff performs compliance reviews on educational institutions based on their cohort default rates, and for lenders based on their guarantee volume with EDFUND .

The following functions administered by EDFUND are central to the competitiveness and success of EDFUND:

- Customer Service: EDFUND provides customer service to the schools and students it serves via a network of regional client relations managers located throughout California and the nation. EDFUND's Client Services team of more than 70 client relations managers and support staff consists chiefly of seasoned former school financial aid administrators and lender representatives who work directly with school clients to ensure quality service delivery and strong customer satisfaction. Regional staff also work with high schools, educating staff and students about financial aid programs and participating in financial aid workshops. This level of local, personal and comprehensive customer service was unprecedented when implemented by EDFUND and remains one of its hallmarks in the student loan arena.

- Loan Management Support for Schools and Lenders: EDFUND provides extensive information and technical support for its school and lender customers seeking to track and manage large volumes of student loans.

- General Information Technology Support: The administration of federal student loans is an information-intensive process involving multiple parties and agencies at almost every juncture. Establishing and maintaining a smooth, reliable and timely flow of information and data transactions among students, schools, lenders, federal authorities and a guaranty agency requires extensive and continuously available technical support. EDFUND consistently provides these to all its partners in the financial aid process through its loan management system and several auxiliary Web-enabled functions and services. In 2004, EDFUND upgraded its mainframe, improving performance and providing a path for future growth.

- Communications and Outreach: EDFUND strives constantly to keep students, parents, schools, lenders and policy-makers well informed about financial aid opportunities, programs, policies and developments. Communication and outreach efforts include the production and coordination of a wide range of informational workbooks, research reports, videos, newsletters and other targeted outreach materials, as well as conference and trade show participation. EDFUND also offers a variety of Web-based tools for students and schools, including EDFUND.net® (a loan processing system for schools that is being phased out and replaced by gps – The EDFUND Student Loan Navigator™), EDWISE® (an online financial planning guide for students), EDTE$T® (an online loan counseling tool for students and schools), and a library of informational streaming video presentations.

Summary of Key Measurements

Loan Guarantee Volume
Total loan dollars, including consolidations, equaled $9.3 billion, a decrease of 7.7 percent from the $10.1 billion for the prior fiscal year. Loan volume was primarily impacted by a shift of two lenders to other guarantors at one of the Commission/EDFUND's largest school customers. The successful efforts of EDFUND's client relations managers increased loan volume at other schools and virtually offset the losses at the one of the Commission/EDFUND's largest school customers.

National Guarantor
Prior to 1999, the Commission's loan program was restricted to the in-state (California) market. Legislation enacted in 1999 authorized the Commission to expand its loan operations out of state. In 2006-07, the Commission was one of the nation's leading guarantors and 55 percent of the Commission's loan guaranty volume was for students attending out-of-state institutions. Approximately 77 percent of the loan guarantee volume, excluding consolidations, was for borrowers at for-profit and proprietary institutions. This relatively high proportion of proprietary school loan guarantees might be described as a mixed blessing. The large volume of proprietary school loans produces Loan Processing Issuance Fee (LPIF) and Account Maintenance Fee (AMF) revenue for the Commission/EDFUND. It also results in the Commission/EDFUND having higher-than industry average loan default rates and associated claims payments. The defaulted loan claims in turn provide the collection revenue opportunities discussed below.

Defaulted Loans
Default claim dollars totaled $703 million for fiscal year 2006-07. This was a 35.5 percent increase from the $519 million for the prior year. Incoming delinquent accounts increased 23 percent in fiscal year 2005-06, which is the population of borrowers at risk of defaulting in fiscal year 2006-07. This volume, coupled with a 29 percent increase in 2005-06 first-time delinquencies (47 percent of defaults are comprised of first time delinquencies) are the primary contributors to the increase in defaults. Sixty-five percent of the dollars that defaulted were from the high-risk segments (two-year public, private and proprietary schools and four-year proprietary schools). EDFUND, together with the help of outside vendors, successfully resolved over 800,000 delinquent loans, preventing approximately $3.6 billion in loan defaults.

With 262,664 borrowers in repayment, the Commission's cohort default rate for 2005 was 8.6 percent which is a slight increase from the 2004 rate of 8.2 percent. The Commission's particular school mix for loans makes it likely that the Commission's default rate will continue in the future to be above the national average, which is currently 4.6 percent.

Collections on Defaulted Loans
Net recoveries on defaulted loans for fiscal year 2006-07 totaled $74 million, 23.9 percent more than the $59 million collected during 2005-06. Strategy changes implemented during the previous year have increased cash collections and decreased recoveries from Direct Loan Program consolidations. The $43 million in loan rehabilitations reflected a growth of 128.5 percent and accounted for 58.6 percent of total recovered dollars. Compared to the prior year, Direct Loan consolidations declined 80.2 percent, while wage garnishments were up 77.2 percent and voluntary borrower payments increased 46.5 percent.

Revenue and Services Provided to the Commission and the State

In 2006-07, the State's loan program generated positive net revenues of approximately $39 million. However, other Commission activities funded by its loan program revenue had expenses of $23 million (outreach programs - $11 million; grants administration - $12 million). These added expenses reduced overall operating revenues net of expenses to approximately $16 million for 2006-07.

EDFUND also continued to provide administrative services to the Commission such as mailings, printing, and technology support, which saves the Commission staff time and money. The Commission and EDFUND worked collaboratively to successfully accomplish several synergy projects to help enhance services to student and schools and streamline internal processes.

CHANGES IN DELIVERY OF LOANS ~ PROGRAM ENHANCEMENTS

In 2007, the student loan industry faced several challenges, beginning with the president's budget proposal and Congressional motivation to reduce costs in the FFEL Program. There were also expansive state and federal probes of the relationship between lenders and schools. While guaranty agencies were not the focus of these investigations and inquiries, there were significant cuts to the financing structure of guaranty agencies.

In spite of these tumultuous times in the student loan industry, EDFUND implemented several federally required changes to the delivery and services of loans. EDFUND also provided enhanced customer service while continuing to improve the efficiency of the loan process.

Federal Legislation

The implementation of the following legislation began to impact the FFEL Program in 2006-07:

The Higher Education Reconciliation Act (HERA) of 2005: HERA, also known as Senate Bill 1932 the Deficit Reduction Act, was signed into public law, by President Bush in February 2006. HERA authorized approximately $12 billion, over five years, in cuts to the FFEL Program. The federal loan program operating environment changed dramatically as guarantors, lenders and schools prepared for, and implemented, the provisions of HERA. The major changes impacting the Commission/EDFUND'S loan program were:

- Federal Default Fee
  As of July 1, 2006, guarantors must deposit into the Federal Fund a Federal Default fee of 1 percent of the principal on Stafford and PLUS loans. By rebuilding the Federal Fund through the Federal Default Fee, guarantors will be able to pay their share of defaults and costs of default prevention effort without having to draw from their Operating Funds. The Commission and EDFUND subsidized this fee for loans guaranteed through September 30, 2006. Many large lenders agreed to pay the fee for the remainder of the academic year (October 1, 2006 through June 30, 2007). EDFUND implemented a strategy for fee sharing with lenders for new loans guaranteed after July 1, 2007.

- Collection Strategy
  As of October 1, 2006, guarantors may only retain 10 percent (instead of 18.5 percent) of the revenues earned from defaulted loan collections where the collection effort relies upon replacing defaulted loans with new Consolidation loans and, effective October 2009, they cannot earn collection revenues on replacement Consolidation loans when these loans represent more than 45 percent of their total annual collection recoveries. As a result, EDFUND shifted its collection strategy successfully from consolidation to rehabilitation.

- Higher Annual Loan Limits and New Grad PLUS Program
  While aggregate loan limits for undergraduate and graduate and professional students remain unchanged, as of July 1, 2007 Congress increased annual loan

limits for many borrowers and authorized a new loan program for graduate and professional students (Grad PLUS). In 2006-07, EDFUND reported increases in new loan volume associated with the Grad Plus program along with a slight offsetting decrease in regular PLUS borrowing. Higher loan limits and the new Grad PLUS program both contributed to new loan volume.

The following legislation affects guaranty agencies, lenders and borrowers beginning October 1, 2007:

<u>The College Cost Reduction and Access Act of 2007</u>: Congress approved the College Cost Reduction and Access Act, more commonly known as the budget reconciliation bill. The act's goal was to generate tens of billions of dollars in savings, with a substantial portion of the savings extracted from the federal student loan program.

Provided below are the major changes to the FFEL Program that affect guaranty agencies, lenders and borrowers:

Guaranty Agency:

- Reduce guaranty agency retention allowance on collections of defaulted loans from 23 percent to 16 percent beginning October 1, 2007.
- Decrease guaranty agency annual account maintenance fees from 0.1 percent to 0.06 percent beginning October 1, 2007

Lenders:

- Cut by 55 basis points the special allowance rate for Stafford and Consolidation loans made by for-profit lenders, and 40 basis points for nonprofits, for loans made on or after October 1, 2007. This reduces the revenue that lenders can make on loans.

- Cut by 85 basis points the special allowance rate for Grad PLUS loans made by for-profit lenders and by 70 basis points for Grad PLUS loans made by nonprofits beginning October 1, 2007. Cut by the same amount for parent PLUS loans that are not subject to the auctions that commence for loans made after July 1, 2009.

- Eliminate exceptional performer beginning in October 2007, but entities with designations in place prior to October 1, 2007, will continue as exceptional performers and receive 99 percent insurance on claims filed through the end of their one-year designation period.

- Reduce lender insurance from 97 percent to 95 percent for loans made on or after October 1, 2012.

- Double the lender-paid origination fee for all loans to 1 percent beginning October 1, 2007.

Students/Borrowers:

- Income-based repayment is established for both FFELP and Stafford student loan borrowers (excluding parent PLUS borrowers). Repayments of Stafford loans are limited to 15 percent of discretionary income, where discretionary income is the difference between adjusted gross income and 150 percent of the federal poverty line. The U. S. secretary of education pays accrued interest on subsidized loans for borrowers for three years, after which all interest is capitalized. Interest is capitalized on unsubsidized Stafford and Grad PLUS loans. Debt remaining after 25 years of income-based repayment is forgiven.

- Borrower interest rates are reduced on subsidized Stafford loans. Reductions begin with a drop to 6.0 percent for loans for which the first disbursement is on or after July 1, 2008. The reductions are phased in one year at a time, and each subsequent reduction also goes into effect for loans for which the first disbursement is on or after July 1. The rate drops to 3.4 percent for loans made from July 1, 2011, through June 30, 2012, then goes back up to 6.8 percent.

- Unsubsidized Stafford loans retain a rate of 6.8 percent and PLUS loans stay at 8.5 percent for FFELP and 7.9 percent for direct lending. Here is the detail for subsidized Stafford loans:

  For a loan for which the first disbursement in made on or after July 1, 2006, and before July 1, 2008, the interest rate would be 6.8 percent.

  For a loan for which the first disbursement in made on or after July 1, 2008, and before July 1, 2009, the interest rate would be 6.0 percent.

  For a loan for which the first disbursement in made on or after July 1, 2009, and before July 1, 2010, the interest rate would be 5.6 percent.

  For a loan for which the first disbursement in made on or after July 1, 2010, and before July 1, 2011, the interest rate would be 4.5 percent.

  For a loan for which the first disbursement in made on or after July 1, 2011, and before July 1, 2012, the interest rate would be 3.4 percent.

  For a loan for which the first disbursement in made on or after July 1, 2012, the interest rate would be 6.8 percent.

- Loan forgiveness for public service employees is created. Effective October 1, 2007, all Direct Loan borrowers, including consolidation borrowers, in certain jobs who make 120 monthly on-time payments, can have the rest of their loans forgiven although they would face a federal income tax liability on the amount forgiven. Public service jobs include all who work in government, emergency management, military service, public safety, law enforcement, public health, public education (including early childhood education), social work in a public child or family service agency, public interest law services (including prosecution or public defense or legal advocacy in low-income communities at a nonprofit organization), public child care, public service for individuals with disabilities, public service for the elderly, public library sciences, school-based library sciences and other school-based services, at any nonprofit charitable (or 501(c)(3)) organization, or as a full-time faculty member at a tribal college or university.

- Student Loan Deferments are expanded for members of the Armed Forces for the period of mobilization plus 180 days (applies to FFEL, Direct and Perkins loans).

- Borrowers who have a Consolidation loan are allowed to obtain a subsequent Consolidation loan under the Direct Loan Program for the purpose of getting an income-contingent loan repayment plan or for using the public service loan forgiveness program authorized in the bill.

The following legislation may further impact the FFEL Program in 2007-08:

Reauthorization of the Higher Education Act (HEA): Although the U.S. Senate passed the Higher Education Act in July of 2007, the U.S. House of Representatives has not yet taken up the bill and will attempt passage in early 2008. The HEA was extended, once again, by Congress; this time through March 31, 2008. The HEA has been subject to the reauthorization process now for seven years and observers are hopeful that a comprehensive bill will be passed this year.

Voluntary Flexible Agreement

Voluntary Flexible Agreement: Since the 1998 Reauthorization of the HEA, FFEL Program guaranty agencies were offered the opportunity to submit applications to ED to provide services under a Voluntary Flexible Agreement (VFA). Five guaranty agencies including the Commission/EDFUND, had their VFA proposals approved. A VFA incorporates and modifies the guaranty agreements under sections 428 (b) and (c) of the HEA, and is intended to enhance program integrity, increase cost efficiencies, and allow flexibility to experiment and improve delinquency and default prevention. The Commission's VFA started with several experiments and now focuses on the success of the Early Withdrawal Counseling (EWC) program. EDFUND's research indicated that student borrowers who leave school prior to completing their program are much more likely to default on their student loans than those who finish their programs. Using this research as a foundation, EDFUND developed an innovative EWC program that targets these borrowers and provides specific services that have not only shown positive results in default prevention, but also positively impact the borrowers' completion rates in school.

When VFAs were created by Congress in 1998, there was a stipulation in the law that they must be "cost neutral." According to ED, the cuts to the financing model for guaranty agencies as part of the College Cost Reduction Act meant the VFAs were no longer cost neutral. In October 2007, ED announced it would terminate the VFAs with guaranty agencies on December 31, 2007. Legislative language included in the Omnibus Appropriation Bill directs the U.S. Secretary of Education to renegotiate VFAs with FFEL Program guaranty agencies no later than March 31, 2008. EDFUND, on the Commission's behalf, will participate in negotiations with ED to develop a new VFA.

EDFUND Improvement Initiatives

Borrower Initiated Loan Application Processing: On December 11, 2006, EDFUND launched a guarantor flow, borrower initiated loan application (BILA) product. The product provides schools an alternative to the traditional lender flow process, and includes the added student benefit of a single point of contact for Stafford loan processing. The school enjoys time savings with a borrower initiated process since the financial aid office is prompted to certify only those loans that students have actually requested, rather than certifying possible loans up front and then waiting for the student to finalize the loan request.

The BILA product is fully integrated with EDFUND's current Loan Portal and can be a component to a full-servicing model with EDFUND products. For example, a school can direct their students to EDTE$T for entrance counseling, connect to the Loan Portal to view lender benefits and loan requests, and then complete other forms requested by the school online with the QuickForm product.

Cohort Management System**:** EDFUND's Cohort Management System product, now serving over 500 schools, has been enhanced to provide "real time" borrower demographic updates between schools and EDFUND'S mainframe. EDFUND hosted eight webcast training sessions with 56 schools in attendance and continues to encourage use of the CMS product for targeting default prevention efforts on campus.

The CMS product was also enhanced to include the Grad PLUS Loan. While Grad PLUS does not figure into the default rate calculation, it is an important element when counseling borrowers on their total loan indebtedness and repayment options. This modification was prompted by the HERA changes which became effective July 1, 2006.

Communications Switch Replacement: On March 19, 2007 EDFUND implemented a new communication switch for EDFUND and CSAC. This switch replaced the telephone switch that was installed when the organization moved into its current headquarters building ten years ago. In addition to providing stable telephone services, the new switch positions EDFUND for using voice-over Internet protocol (VoIP). This technology will reduce costs, provide new functionality for the call centers (call routing flexibility and improved voicemail) and provide the next step toward unifying e-mail and voicemail.

Corporate Account Services: To enhance the default prevention efforts of our corporate school clients, EDFUND provided ongoing webcast training on topics such as Delinquent Borrower Counseling, Loan Repayment Options, and Cohort Management System training.

Default Prevention: EDFUND continues to support schools with a focus on lowering defaults. This year, EDFUND increased its training events by 10 percent and at the same time reduced costs by utilizing webcast technologies.

To maximize the chance that all EDFUND borrowers will successfully repay their loans, two external servicers have been assigned a portion of EDFUND borrowers in the late stages of delinquency (approximately 180 days delinquent), plus those accounts without a valid phone number. EDFUND is closely monitoring each vendor's performance to ensure borrowers are receiving quality service and that the vendor is effective in resolving delinquencies.

EDFUND Institute: As part of a larger effort to bring more strength and clarity to the EDFUND name in the marketplace, the four areas within EDFUND that provide training to school and lender staffs are being placed under a single umbrella -- the EDFUND Institute. As part of this branding effort, all materials -- printed and electronic -- are being re-designed to share one focused look, and one single logo. The first re-branded workshop took place in September 2007, and initial feedback is very positive.

EDTE$T**:** EDFUND's online loan counseling tool has been updated to reflect the most recent regulatory changes.

Flexible Automated Collection System (FACS) Dialer Replacement Project: EDFUND installed added security features to its predictive dialer system used in the Default Prevention and Internal Collections Call Centers. Users are now required to enter a unique ID and password. The password will expire periodically and users will have to establish new secure passwords.

Lender List-Related Enhancements: Schools that utilize the EDFUND WEBapp or EDFUND Loan Portal products can now address preferred lender lists and borrower choice in two ways:

- Lender list randomization -- showcases a school's list of lenders in rotating random order.
- Additional FFEL Program lender list -- displays a comprehensive list featuring more FFEL Program lenders available to borrowers.

EDFUND has also added language to its Web-based products informing borrowers about their right to select any lender or guarantor. For schools who want to provide borrowers with a comprehensive lender list, EDFUND has made the additional FFEL Program lender list available on its Web site.

New and Improved Publications and Videos
About EDFUND brochure: An overview highlighting EDFUND's customer service, training, processing and technical capabilities.

Awards: EDFUND collected 10 awards from the prestigious Magnum Opus Awards, a national contest sponsored by Publications Management and the Missouri School of Journalism. It is the only awards program dedicated exclusively to corporate and custom publishing. Judges, including the nation's top custom-publishing professionals and professors from The Missouri School of Journalism, reviewed over 800 entries from noteworthy companies such as Walt Disney, Toyota, American Airlines, Nickelodeon and Aetna. Grand, gold, silver, bronze and honorable mention winners were selected.

- Special Recognition: Outlook: Graduate Entrance Guide
  Grand Award – Print, Other Publication
- *Silver Award:* EDFUND's external newsletter, *NewSource*
  Best Regularly Featured Column: MoneyMatters
- *Bronze Award:* EDFUND's external newsletter, *NewSource*
  Best Use of Black & White Photography
- *Bronze Award:* Outlook: Graduate Exit Guide
  Best Table of Contents Design
- *Bronze Award:* EDFUND'S internal newsletter, *Kaleidoscope*
  Most Improved Design
- *Bronze Award:* EDFUND's EDSHARE Web site
  Best Publication Companion Web Site Design
- *Honorable Mention:* EDFUND's external newsletter, *NewSource*
  Best Interview/Profile, "Helping Them Help Themselves"
- *Honorable Mention*: EDFUND's external newsletter, *NewSource*
  Best Public Service Series/Article, "Take the Initiative"
- *Honorable Mention*: The *Fund Your Future Workbook*
  Best Table of Contents Design
- *Honorable Mention*: The *Fund Your Future Workbook*
  Best Cover

Building Futures Entrance & Exit Loan Counseling: PowerPoint presentations and instructor guides have been updated to reflect the most recent regulatory changes so that schools may continue to provide their borrowers with complete and accurate information during their borrowing experience.

Credit for College booklet: A booklet for high school students that helps demystify college and financial planning issues.

EDFUND Link: EDFUND's e-mail communications to customers and industry partners were joined as one in the EDFUND Link product. Available in HTML and text e-mails, "teaser" story links open to a Web page with all stories in full. Launched September 7, 2007.

Entrance Guide: Zone In on Your Student Loan: For college students, a magazine-style guide that helps new borrowers plan for and ensure the timely repayment of their student loans. Updated to reflect new Stafford loan limits that became effective July 1, 2007.

FAFSA for Students/Parents Video— A guide to filling out the 2007-08 FAFSA: Full of helpful hints and step-by-step information to help parents and students fill out the FAFSA accurately. Four separate VHS videos and now, all four versions have been compiled onto one DVD. Online versions are also streamed on the EDFUND Web site.

Federal Stafford Loan Interest Rates and Loan Limits: Designed as a hand out for students, this simple flyer shows the current year's federal student loan interest rates as well as the annual and aggregate borrowing limits.

Federal Tax Benefits at a Glance -- A Guide for Students and Parents: A concise fact sheet summarizing tax credits, tax deductions and saving incentives for higher education for tax year 2006.

Fund Your Future Counselors' Guide Financial Aid Fact Sheets: Extracted from the 2007-08 California Counselors' Guides, these fact sheets are available as a separate download. They provide an overview of the major financial aid programs and how to apply for them, in eight languages.

Guide to Federal Tax Benefits for Higher Education: Tax Year 2006: A comprehensive booklet to higher education tax incentives including the most recent updates to the tax laws.

Loan Cancellation for the Death of the Borrower: One-page document that describes the steps to take in the event of the death of a student or parent borrower. Includes helpful URLs, phone numbers and approximate time frames**.**

Loan Consolidation for Grad PLUS Borrowers: A compact two-page PDF that can be printed as a handout, with essential information for Grad PLUS loan consolidation. Includes advantages and disadvantages of consolidating loans; why to consolidate now— including a table that shows how loan repayments are affected if the borrower decides to consolidate; and frequently asked questions.

National Student Loan Data System Card: Handy tri-fold, business card-sized reference piece with basic information for students on NSLDS and how to access it.

Ombudsman brochure: A concise overview of the alternative dispute resolution services offered by EDFUND's Ombudsman's Office, one of the first among guarantee service providers.

PLUS Loan Wraparound and School Certification Guide: Updated based on new guidance from ED and changes in the Higher Education Reconciliation Act.

Private Loans card: Condensing a tri-fold booklet, this handy card provides borrowers a top-ten list of questions to ask prospective lenders when seeking a private loan to fund their education.

Spanish PLUS brochure: A quick-read brochure in Spanish about the borrowing options for parents and stepparents. Revised to reflect changes in federal law.

Stafford brochure: Explains the ins and outs of federal Stafford loans to students and their families. Includes loan information that became effective July 1, 2007.

Stafford Loan Wraparound: Updated based on new guidance from ED.

Step-by-Step Look at Loan Consolidation booklet: A guide for borrowers considering consolidating their student loans.

Text-Only Format: A number of EDFUND publications have been converted into text to make them more accessible to readers with reading impairments. The list has been expanded to include EDFUND's most popular publications and all files are now in Microsoft Word format.

Writing Tips: A two-sided sheet, available for download, with useful writing tips for financial aid staff. Includes links to resources on writing and design.

Rehabilitation Restructure: Greater functionality was added to several of EDFUND's rehabilitation products. In addition, EDFUND automated the identification, verification, and collateral processing for eligible rehabilitation accounts within EDFUND's mainframe. The result has been a 50 percent reduction in the required number of staffing hours.

School-based Software: **gps** - The EDFUND Student Loan Navigator is EDFUND's new school-based software product. It replaces two current products (PCFAPS and EDFUND.net) with one that is more robust in its application processing features, providing school users more flexibility and processing options. The introduction of **gps** allows EDFUND to better meet the needs of its existing school customers, while also positioning the company to be more competitive in the marketplace.

Student Loan Debt Summary: As part of EDFUND's mission to provide benefits to borrowers, EDFUND sends over 650,000 statements to borrowers currently enrolled at 420 participating institutions. As a cost-savings measure, EDFUND has moved over one hundred schools to an Electronic Loan Debt Summary.

Other Initiatives

College Access Web Site*:* Developed in response to HERA, www.going2college.org features comprehensive information for students and families about career preparation, planning for college, finding a college and paying for college. The Commission/EDFUND is responsible for details about California's programs and services. A workgroup composed of Commission and EDFUND staff has been established to update and enhance the site quarterly.

Summary of Achievements

In a year filled with considerable pressure and changes, EDFUND provided positive results:

- Recording new Stafford and PLUS loan volume of $6.8 billion (nearly equaling 2005-06) even with the competitive challenges posed by the implementation of the federal default fee. Client relations managers had more than 15,000 meaningful contacts with customers and potential customers.

- Processing a record number of claims, assisting a record number of defaulted borrowers, improving collection recoveries 23.9 percent, increasing gross rehabilitation volume by 128.5 percent, and executing major strategic planning objectives, all while increasing efficiencies including eliminating over 900 paper lender reports.

- Completing more than one million manual loan transactions 99.9 percent on time and with 99.6 percent quality.

- Answering 95 percent of customer calls within 20 seconds and providing a call quality of 97 percent – all with an increase in call volume of 17 percent.

- Offering 641 free training events on loan processing, financial literacy and professional development to financial aid and industry partners, a 10 percent increase at less cost than 2005-06; 92 percent of attendees rated the events as "very good" or "excellent".

- Successfully resolving over 800,000 delinquent loans, preventing approximately $3.6 billion in loan defaults.

ANNUAL BUDGET

With the passage of the 1998 Reauthorization of the Higher Education Act, two funds were created to take the place of the former Federal Guaranteed Loan Reserve Fund. Based on FFEL Program requirements, State law created the Federal Student Loan Reserve Fund (Federal Fund) and the Student Loan Operating Fund (SLOF) in the State treasury in 1999. Federal law establishes FFEL Program revenue sources and allowable expenses for each fund. The assets of the Federal Fund are the property of the federal government, and their main purpose is to pay lenders for defaulted student loans. Money in the SLOF is the property of the State and must be used for loan program operating expenses and/or the support of financial aid-related activities.

The Commission and EDFUND's actual SLOF revenues and expenses for FFY 2006-07 appear in Figure 1. EDFUND operates on an October 1 through September 30, fiscal year, reflecting the federal budget cycle.

Figure 1: Commission and EDFUND Student Loan Operating Fund Statement of Revenues and Expenses For FFY 2006-07
($ in thousands)

REVENUES:	
Net recoveries on loan defaults*	$73,552
Account maintenance fee	$29,996
Loan processing and issuance fee	$22,605
Default aversion fee	$13,420
Lender premium fee	$1,615
Interest income	$1,820
Voluntary Flexible Agreement/other revenues	$10,329
Total Revenues	**$153,337**
EXPENSES:	
Loan program personnel costs	$55,790
Operating expenses	$21,739
Collection agency expense	$11,299
Federal default fee subsidy	$22,404
Restricted expenses	$1,538
Borrower benefits-EDSHARE	$64
Commission FFEL Program operating expenses	$1,205
Total Loan Program Expenses	**$114,039**
LOAN PROGRAM REVENUES NET OF EXPENSES	**$39,298**
Outreach programs	$11,415
Grant administration costs	$11,903
Total Non-Loan Expenses	**$23,318**
OVERALL OPERATING REVENUES NET OF EXPENSES	**$15,980**

* Recoveries on loan defaults, net of ED's equitable share and the claim purchase complement. This amount includes fees earned from consolidating defaulted loans through the Direct Loan Program.

In FFY 2006-07, total loan program revenues earned by EDFUND were $153 million. Loan program expenses ($114 million) and non-loan program expenses ($23 million) resulted in overall operating revenues exceeding expenses by approximately $16 million. Loan program expenses were comprised of $92 million in operating costs and $22 million in federal default fee subsidy funding on behalf of student borrowers. Non-loan program expenses funded $11 million in Cal-SOAP, outreach and public awareness programs along with $12 million in grant administrative costs.

Revenues

FFEL Program revenue is derived from six specific sources authorized and regulated by ED. The rate of federal reimbursement for certain services provided by EDFUND was reduced by federal legislation enacted by Congress effective October 1, 2007. The Commission and EDFUND also generated revenue under a VFA negotiated with ED. Although ED terminated all guaranty agency VFAs effective December 31, 2007, legislative language included in the Omnibus Appropriation Bill directs the U.S. Secretary of Education to renegotiate VFAs no later than March 31, 2008. EDFUND, on the Commission's behalf, will participate in negotiations with ED to develop a new VFA.

The Commission uses no California General Fund support for the administration of the FFEL Program. In fact, as noted in the Background section of this report, funds generated by the loan program were appropriated from 2003-04 through 2006-07 for Commission administrative expenses as well as grant awards and outreach programs previously paid by the General Fund.

The revenue sources are:

- **Net Recoveries on Loan Defaults** – Collection dollars retained after ED's fair share is deducted. The collection retention percentage from borrower payments was reduced by recent federal legislation from 23 percent to 16 percent effective October 1, 2007. Similarly, while retention on rehabilitation loan recoveries remains at 18.5 percent, collections on defaulted loan consolidations decreased the prior year from 18.5 percent to 10 percent effective October 1, 2006.

- **Account Maintenance Fee** – 0.10 percent of the original principal in the outstanding loan portfolio is paid to the guaranty agency on an annual basis. The rate was reduced to 0.06 percent effective October 1, 2007.

- **Loan Processing and Issuance Fee** – 0.40 percent of the principal of new loans guaranteed is paid to the guaranty agency at time of loan disbursement.

- **Default Aversion Fee** – 1 percent of the principal and interest on loans more than 60 days delinquent that are brought current by counseling borrowers before the loan becomes 270 days delinquent and enters default. This fee is available for first-time default aversion assistance requests only, is paid from the Federal Fund, and must be refunded if the borrower subsequently defaults.

- **Lender Premium Fee** – This fee is based upon a contractual relationship developed with a lending partner. A scaled premium fee is paid by the lender when purchasing loans qualifying for rehabilitation or consolidation.

- **Interest Income** – Interest income from funds held in the Student Loan Operating Fund.

- **Voluntary Flexible Agreement** – Performance-based payments made by ED under the negotiated terms of the agreement. Although VFA revenue was received for FFY 2006-07, with ED's termination of the VFA only one quarter of VFA revenue will be received for budget year FFY 2007-08.

Personnel

The ability to recruit, hire, promote and compensate staff outside of State civil service was one of the key competitive advantages presented by the opportunity to transfer the Commission's student loan administrative and servicing functions to EDFUND. Ensuring fair and equitable treatment of all employees regardless of their status as EDFUND direct hires or State civil service employees continues to be a major priority for EDFUND and the Commission.

In an effort to address these aims, Assembly Bill 3133, the legislation authorizing the Commission to establish EDFUND, provided a mechanism whereby state civil service employees whose functions were transferred from the Commission into EDFUND could opt to remain state civil service employees of the Commission while being assigned to work for EDFUND. Of the 591 people employed at EDFUND as of September 30, 2007, 548 (93 percent) were EDFUND direct hires and 43 (7 percent) were State civil service employees of the Commission assigned to work for EDFUND.

EDFUND is an equal opportunity employer providing opportunity to all regardless of race, color, creed, national origin, ancestry, sex, marital status, disability, religious or political affiliation, age or sexual orientation.

LEVEL OF COMPENSATION OF MANAGERS AND EXECUTIVES

Members of the EDFUND Board of Directors are appointed by the Commission and do not receive a salary. Compensation of a $100 stipend is given for each day when the Board or Board Committee meets. Reimbursement for actual and necessary travel expenses is also provided.

EDFUND management salaries are based on national salary surveys of comparable non-profit corporations both within and outside of the student loan industry, and are based on a combination of EDFUND norms and individual qualifications. Executive management salaries are set by the EDFUND Board of Directors; all other salaries are set by the Human Resources Division based on local market surveys and salary data, and in consultation with hiring managers. Salaries are set based upon national competitive averages. EDFUND's executive management may receive incentive compensation as set forth in the Operating Agreement pursuant to the Commission's "Policy Statement and Guidelines Memo for EDFUND Incentive Compensation Plans." The Chair of the Commission reviews the incentive compensation amounts based on performance reports provided by the EDFUND Board and the Executive Director. The Commission Chair may either approve or decrease the incentive compensation amounts recommended by the EDFUND Board. If either the Executive Director or the EDFUND Board disagrees with the decision rendered by the Commission Chair, one or both may request a closed session review by the Commission. The decision of the Commission is final.

For FFY 2006-07, incentive compensation was also approved by the DOF. Chapter 182, Statutes of 2007 (Senate Bill 89) requires that increases in compensation or benefits for EDFUND officers, including discretionary bonuses and retention bonuses, be approved by DOF. EDFUND executive management received approximately $1.9 million in total compensation for 2006-07.

Figure 2 includes both regular salary and incentive compensation to EDFUND's executive management for 2006-07. The amounts do not include salary adjustments approved by the EDFUND Board of Directors for 2007-08.

Figure 2: EDFUND Executive Management Compensation FFY 2006-07

Position Title	**Total Compensation**
President	$338,951.00
VP, Finance and Administration	$243,224.00
VP, Legal and External Relations	$225,760.00
VP, Loan Operations	$212,544.00
VP, Client Services	$194,585.00
VP, Default Management	$190,223.00
VP, Information Technology Services	$175,000.00
VP, Audit Services	$170,557.00
VP, Human Resources	$165,583.00
Total	**$1,916,427.00**

Notes:
VP, Human Resources vacated on December 15, 2006; filled on June 1, 2007.
VP, Information Technology Services vacated on March 13, 2007; filled on June 23, 2007.
The compensation includes all incumbents.

CONCLUSION

The Commission and EDFUND worked to overcome significant competitive challenges from changes to the guarantor environment in the 2006-07 fiscal year. Even with escalating competitive pressures and the proposed sale of EDFUND, the Commission and EDFUND will continue to strive for growth in the FFEL Program for the benefit of students in California and across the nation. EDFUND's reputation for providing premier service to schools and students remains its greatest strength, and drives the continued expansion of its nationwide base.

However, new requirements contained in the Higher Education Reconciliation Act of 2005 and the College Cost Reduction and Access Act of 2007 significantly impact the EDFUND business model. More and more schools have begun choosing guarantor and lender partners on price rather than service, while reimbursement levels from the federal government were reduced. In recent weeks, several lenders have announced their intentions to leave or limit their participation in the FFEL Program, as a result of the recent instability in the credit markets and recent lender subsidy cuts on FFEL Program loans. Industry analysts say that, at this time, it is too soon to tell what the full impact of these conditions will have on lenders and ultimately students and families.

The federal changes not only impact the FFEL Program, but have significantly affected the Commission's other financial aid programs. The Commission's administrative budget and Cal-SOAP were supported from the Student Loan Operating Fund (SLOF) for the past four years. Funding from the SLOF allowed the Commission to manage growth and maintain funding levels in the Cal Grant Program and in Cal-SOAP during periods of General Fund reductions. The projected 2007-08 FFEL Program revenue reductions indicated that the SLOF could no longer support both the FFEL Program and other Commission programs.

In response to the significant changes in the FFEL Program, the Governor announced the proposed sale of EDFUND in May 2007 and signed Chapter 182, Statutes of 2007, (Senate Bill 89) to establish the process for the sale. To preserve the assets in the student loan program, the Commission's administrative budget and funding for Cal-SOAP was shifted from the SLOF back to the State General Fund in State Fiscal Year 2007-08.

In anticipation of the sale of EDFUND, the Governor's Proposed 2008-09 Budget includes additional resources in the Commission's budget for prospective activities necessary to reestablish essential core business and technology services that EDFUND has been providing to the Commission; but at the same time proposes the elimination of the Cal Grant Competitive Program, reduces the Cal-SOAP, and imposes a 10 percent budget reduction to the Commission's administrative budget.

The Commission will have to manage the transition of services along with the reassignment of civil service employees currently assigned to EDFUND while also coping with a significant budget reduction in 2008-09. The transitioning of employees with loan program experience to the Commission's grant programs and the potential loss of the experienced employees currently administering the grant programs could have serious implications in the Commission's ability to provide services to students and schools. The Commission has a very daunting task of ensuring that the awards and payments to students are not delayed due to the sale of EDFUND and implementation of budget reductions.

As of March 17, 2008

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University of California Representative

Tomas Arciniega
California State University Representative

Lynne de Bie
California Secondary Schools Representative

Yasmin Delahoussaye
California Community Colleges Representative

Daniel Friedlander
Senate Rules Committee Representative

Peter Hankwitz
Public Member

Lorena Hernandez
Senate Rules Committee Representative

Patricia Fong Kushida
Public Member

Bonaparte Liu
Public Member

Enrique Murillo
Speaker of the Assembly Representative

Israel Rodriguez
California Independent College or
University Representative

Antonio Solorzano, Jr.
Speaker of the Assembly Representative

Three Vacancies
California Postsecondary Educational
Institution Student Representatives (2)
California Public, Proprietary or Nonprofit
Postsecondary School Representative

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Executive Director

Keith Yamanaka
Chief Deputy Director

John Bays
Chief, Information Technology

Robert Illa
Acting Chief; Management Services Division

Janet McDuffie
Chief, Federal Policy and Program

Catalina Mistler
Chief, Program Administration and Services

Keri Tippins
General Counsel

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California Student Aid Commission

Sam Kipp
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Martin Scanlon
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Linda Weir
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